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Feasibility study for an interregional trade financing facility for the exports of non-traditional goods of developing countries

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EXECUTIVE SUMMARY

The purpose of this study is to explore how to utilize international capital markets to provide trade finance to developing countries in support of export-oriented policies. Specifically, it considers how a new international trade finance facility (ITFF) might contribute to greater access to trade finance by LDCs, especially for non-traditional exports involved in South-South trade.

The ITFF, under the most realistic scenarios we have conceived, should within five years be able to provide between $1.4 billion and $7.9 billion annually of developing country exports. According to UNCTAD analysis, the financing need for developing-country exports ranges from $6.3 billion to $9.1 billion annually in the low case and $9.8 billion to $14.9 billion annually in the high case. Making the ITFF available would thus increase South-South trade by approximately six percent annually and meet up to 86 percent of the projected low-case annual need of $9.1 billion.

We expect that the ITFF will fund roughly half of its lending activity by a variety of borrowings, including time deposits (probably by shareholders), lines of credit, and bond issues. Of these sources, the most difficult to obtain will be bond financing. By designing an institution that meets the criteria demanded in the bond market, the criteria of other markets will also be met. Therefore, we believe that the ITFF's financial and management policies should be designed to meet the definition of commercial viability used in the bond markets.

"Commercially viable" in this context thus can be defined as the ability of the ITFF to fund itself at affordable premiums in global capital markets. This means that (1) the ITFF will pay a return on bonds high enough to attract investors away from comparable bonds, but (2) low enough to guarantee sustainable operating profits for the institution. In other words, the ITFF should pay greatest attention to factors that will make its bonds as close to investment grade as possible.

The ITFF's lending and management policies should be constructed in a way that reflects these interests:

Types of Facilities and Financing

The ITFF should be involved in providing short-term and, to the extent feasible, medium-term trade finance to importers and exporters in developing countries. At the same time, for the ITFF to be successful it should not restrict its activities exclusively to non-traditional, South-South trade. It should rather restrict itself to exports from developing countries, with a clear preference for non-traditional goods and for South-South trade. Because of these particular characteristics of its portfolio, the ITFF should provide financing through a single "window."

Use of Guarantees

The ITFF should probably use guarantees only to enhance the assets in its portfolio. It should not issue guarantees of its own on loans extended by other financial institutions because this would create off-balance-sheet liabilities that would call into question the creditworthiness of the ITFF in the eyes of bondholders. Finally, it is unlikely that the ITFF could secure guarantees for its bond obligations since those entities that might issue these guarantees would have little reason to do so. (The ITFF might consider using callable capital as a basis for issuing guarantees to its creditors, but there are several reasons why this would be of little value.)

Risk Management

The ITFF should minimize credit risk by creating an effective counterparty and guarantor evaluation process, and by relying on country limits for its lending, as most financial institutions do. To assist in this process, shareholders would be required to set up independent local "focal points" that would initially process local applications for credit. Also, it should control its maturity risk by concentrating its lending activities in short-term facilities and extending medium-term credits only to the extent compatible with maintaining sufficiently high bond ratings in the markets. Further, the ITFF should avoid any foreign exchange risk. Finally, the ITFF should minimize its funding risk by matching maturities of assets and liabilities as closely as possible, and by relying on floating interest rate loans almost exclusively.

Country Coverage

The ITFF should consider financing exports only from shareholder countries, but the ITFF should ignore its shareholder representation in setting lending policies. Medium-term financing would be available almost exclusively to Class A countries because of market perceptions of lower-rated sovereigns, but it should seek to extend short-term financing, which is less risky to its portfolio, across as wide a range of countries as would be feasible.

Capitalization and Leveraging

Based on how other MDBs and trade finance institutions operate, the ITFF should utilize only paid-in capital and avoid callable capital. (The market may not ascribe much value to callable capital and related guarantees if they come primarily from developing-country shareholders.) The ITFF should be able to seek an eventual leverage ratio of between 5:1 and 10:1. Using the a forfait market could enhance the ability of the ITFF to leverage its resources.

Short-term versus Medium-term Lending

Another reality of markets is that the ITFF will have to concentrate primarily on short-term financing because this will guarantee the smallest possible risk profile for the institution as perceived in the bond market. This does not mean, however, that the ITFF cannot offer any medium-term financing, or that the ITFF cannot change